In the Supreme Court of the United States

OCTOBER TERM, 1938

JAMES M. LANDIS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 18

JAMES E. DAVIDSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 9–22) is reported at 34 B. T. A. 555. The opinion of the Circuit Court of Appeals (R. 32–37) is reported at 94 F. (2d) 300.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 31, 1938 (R. 38). A petition for rehearing was denied February 22, 1938 (R. 39). The petition for a writ of certiorari was

filed April 1, 1938, and was granted May 16, 1938 (R. 43). The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxable gain from the sale of 1,000 shares of certain stock is to be determined, as the Board and the court below held, upon the basis of the cost of the shares which the taxpayer actually sold as represented by the certificates actually delivered to the broker by a bank (through a mistake of the bank), which certificates have been identified, rather than, as the taxpayer claims, upon the basis of the cost of the shares which he intended to sell and which he instructed the broker to sell and the bank to deliver to the broker.

STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.
>
> (a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.
>
> * * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * * *

STATEMENT

The facts relevant to the question here presented, as found by the Board,[1] may be stated as follows (R. 13–14):

On March 27, 1929, the taxpayer, through his broker, purchased 1,000 shares of National Power & Light Company stock with a part of the proceeds of a loan from the Omaha National Bank. Certificates for these shares of stock numbered 80250 to 80258, inclusive, and 80264, were delivered to the taxpayer and were put up as collateral with the bank (R. 13).

On June 19, 1929, the taxpayer instructed his broker to sell 500 of the 1,000 shares purchased on March 27, 1929, the certificates for which were on

[1] The findings of fact and opinion of the Board (R. 9–22) covering both this case and a companion case in which the petitioner's wife was the taxpayer (and in which this Court denied the petition for a writ of certiorari on May 16, 1938, *Edith L. Davidson* v. *Commissioner*, No. 913, October Term, 1937) contains the relevant facts under that portion of the Board's finding of fact headed "National Power & Light Co. Transactions of James E. Davidson in 1929" (R. 12–14).

deposit at the bank. When the sale was made the taxpayer called at the bank to get the certificates for delivery to the broker, but the bank refused to release them to the taxpayer, stating that it would make delivery itself. The taxpayer then instructed the bank to deliver 500 shares from the certificates numbered 80,250 to 80,258, inclusive, and 80,264. In making delivery, however, a bank clerk, by mistake, delivered certificates from another lot which had been held as collateral by the bank since 1925. The mistake was not known to the taxpayer at that time (R. 13-14).

On July 1, 1929, the taxpayer instructed the broker to sell the remaining 500 shares purchased on March 27, 1929, and instructed the bank to deliver to the broker the remaining 500 shares from the certificates above mentioned. Again, however, the bank made the same mistake and delivered to the broker certificates for 500 shares from the lot which had been held as collateral since 1925 (R. 14).

The aggregate proceeds from the sale of these 1,000 shares were $59,435. The cost of the 1,000 shares purchased on March 27, 1929, was $49,900. The cost of the 1,000 shares which were delivered to the broker by mistake was $4,420 (R. 14).

In his return, and in his appeals to the Board (R. 2-5) and to the court below (R. 25-29), the taxpayer claimed that his gain should be computed upon the basis of the cost of the 1,000 shares which

he intended to sell. The Board of Tax Appeals held (R. 18-20) that the shares delivered to the broker were the shares actually sold by the taxpayer, and that the taxable gain is to be determined upon the basis of the cost of the shares represented by the certificates which were actually delivered to the broker. The court below affirmed the decision of the Board (R. 32-37).

SUMMARY OF ARGUMENT

The statute requires that the gain be determined on the cost basis of the shares actually sold and not upon the different basis of other shares of the same stock which the taxpayer intended to sell and instructed his broker to sell. The taxpayer actually sold the shares identified by the certificates delivered in consummation of the sale and not the shares represented by the certificates which he requested the bank to deliver. The taxpayer's designation of the shares he intended to sell in his instructions to the broker does not prevail over the ordinary means of identification of the shares sold by the certificates delivered on the sale. The tax liability was correctly determined upon what was actually done and not upon what was intended to be done.

ARGUMENT

THE TAXABLE GAIN HAS BEEN COMPUTED CORRECTLY UPON THE BASIS OF THE COST OF THE SHARES ACTUALLY SOLD, AS REPRESENTED BY THE CERTIFICATES DELIVERED

On March 27, 1929, the taxpayer through his broker purchased shares of stock with part of the proceeds of a loan from a bank. Certificates for these shares were delivered to the taxpayer and put up as collateral with the bank (R. 13). Later in the same year the taxpayer instructed his broker to sell these shares purchased on March 27, 1929, and instructed the bank to deliver upon the sale the identical certificates which the taxpayer had received when he purchased these shares. By mistake the bank delivered certificates for other shares of the same stock which had been held by the bank as collateral since 1925 and which had a lesser basis for computation of gain. The taxpayer did not know about the mistake at that time (R. 14).

The taxpayer contends, on these undisputed facts, that the instructions to the broker identified the shares sold for purposes of the tax even though the certificates delivered upon the sale in fact represented other shares purchased at a different time. The respondent contends (A) that the statute requires the gain to be determined upon the cost of the shares actually sold and (B) that the certificates delivered upon the sale identified the shares actually sold, prevailing over the instruc-

tions to the broker as the means of identification of the shares sold.

A. GAIN MUST BE COMPUTED ON THE SHARES ACTUALLY SOLD

Section 111 of the Revenue Act of 1928 provides that the "gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, * * *." Section 113 (a) provides that the "basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *"

The respondent contends that this statute requires that the gain be determined on the cost of property sold including shares of stocks if they can be identified, and does not permit that gain to be determined on the different cost basis of similar property or shares which the taxpayer intended to sell but by mistake, of himself or of others, failed to sell.

The taxpayer has the right to have the tax determined on the shares he chooses to sell and does sell rather than other shares which he might have sold (*Helvering* v. *Rankin*, 295 U. S. 123, 129–130) and, conversely, he is bound to pay the tax computed on the shares actually sold.

The court below correctly observed (R. 37) that tax liability must be determined by what in fact is done. *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 98; *United States* v. *Phellis*, 257 U. S.

156, 172. This rule is applied to this situation in which a taxpayer intends to sell certain shares of stock but in fact sells other shares, as represented by the certificates delivered. The tax is computed on the cost of the shares actually sold, whether or not the intention to sell other shares is expressed at the time of the sale. *Curtis* v. *Commissioner*, 89 F. (2d) 736, 738 (C. C. A. 8th); *Vawter* v. *Commissioner*, 83 F. (2d) 11, 13 (C. C. A. 10th), certiorari denied, 299 U. S. 578; *Horner* v. *Commissioner*, 78 F. (2d) 813, 814 (C. C. A. 3d); *Commissioner* v. *Merchants' & Mfrs. F. Ins. Co.*, 72 F. (2d) 408 (C. C. A. 3d); *Horner* v. *Commissioner*, 72 F. (2d) 407, 408 (C. C. A. 3d). The question in each case is which shares actually were sold.

B. THE CERTIFICATES DELIVERED, RATHER THAN THE INSTRUCTIONS TO THE BROKER, IDENTIFIED THE SHARES SOLD

The difference between the sale of stock and other personal property is that it is often difficult, and sometimes impossible, as a matter of proof, to identify the particular shares sold. In this case, however, the undisputed facts are that particular certificates identify particular shares according to the time of purchase. Ten separately numbered certificates were delivered to the taxpayer for the 1,000 shares of stock purchased on March 27, 1929. These identical certificates were deposited as collateral with the bank, which also held other certificates for 2,200 shares of the same stock deposited as collateral in 1925 (R. 11, 14). The bank continued to hold these identical certificates which

continued to represent, identify, and distinguish the shares purchased in 1925 and 1929.

Indeed, the taxpayer in his transactions with these shares of this stock always carefully recognized and never ignored the fact that particular certificates represented particular shares of stock according to the time of purchase. His conduct discloses that he considered that the certificates which he directed the bank to deliver upon the sales in question represented shares purchased on March 27, 1929, and that certificates delivered by mistake represented the shares acquired in 1925.

1. The taxpayer's contention (Br. 27–29) that he did sell the shares purchased in 1929, despite the consummation of the sale by the delivery of the certificates which identified, and which the taxpayer always treated as identifying, the shares purchased in 1925 is not supported, as the taxpayer claims, by *Richardson* v. *Shaw*, 209 U. S. 365, and *Gorman* v. *Littlefield*, 229 U. S. 19, or by *Duel* v. *Hollins*, 241 U. S. 523. Those cases held that upon a broker's bankruptcy, his customers, without identifying the particular certificates of stock deposited with or held by the broker for their accounts, could recover from the bankrupt estate, as their own property without an unlawful preference, different certificates as representing their shares of the stock.

Those decisions have no application here. They are based upon the relation of broker and customer under which "the broker has an implied authority to substitute other securities of the same kind and

amount for the securities which he holds for his customer, * * *." *Provost* v. *United States*, 269 U. S. 443, 455. Under this implied authority the substituted securities become the customer's property and the broker's disposition of the certificates deposited by the customer is not a conversion of the customer's property. It was in connection with this element in the relation of broker and customer under which substituted certificates represent a customer's shares, that the Court stated that identification of particular certificates was unimportant and that substitution of certificates did not change the property right held by the broker for the customer. *Gorman* v. *Littlefield*, 229 U. S. 19, 25; *Richardson* v. *Shaw*, 209 U. S. 365, 378-379.

Moreover, those cases were concerned only with the question of substituted certificates representing all the shares of a customer without distinguishing between different shares owned by the same customer and have no application here where the problem is one of identification between two lots of shares of the same shareholder. Indeed, even the taxpayer must claim that lots of stock can be distinguished in some manner in order to claim that a certain lot was sold and to avoid the first-in first-out rule which is provided by Treasury regulations and applies when the shares sold cannot be identified. For purposes of recovery of shares pledged with a broker they may be treated as

fungible, but for the present purpose where identification of the shares sold is all important they should be treated as distinct articles of personal property. So considered, it is clear on the undisputed facts that the shares purchased in 1925, and not the shares purchased in 1929, were sold.

2. The taxpayer contends (Br. 21) that his instructions to the broker to sell the shares purchased in 1929 control even though the bank upon the sale delivered certificates which identified the shares purchased in 1925. The respondent submits that such instructions may be recognized as a means of identifying the stock sold only in unusual circumstances not present here, when the ordinary means of identification, the certificates, is not available, such as where a taxpayer is trading on margin and his shares are not represented by particular certificates and identification by certificates is impossible. In such a situation the taxpayer might have been left, because of inability to have his stock identified by particular certificates, to accept the first-in first-out rule. Another alternative, however, has been adopted by this Court and, in addition to the ordinary means of identification by certificate, taxpayers in some situations have been allowed to identify shares sold by instructions to a broker to sell shares purchased at a particular time. *Helvering* v. *Rankin*, 295 U. S. 123.

Where, as here, identification by certificate is possible it controls and the shares sold are determined by the certificates delivered upon the sale. The decision of the court below to this effect is supported by the similar rulings in other cases. *Curtis* v. *Commissioner*, 89 F. (2d) 736, 738; *Vawter* v. *Commissioner*, 83 F. (2d) 11 (C. C. A. 10th), certiorari denied, 299 U. S. 578; *Horner* v. *Commissioner*, 78 F. (2d) 813 (C. C. A. 3d); *Skinner* v. *Eaton*, 45 F. (2d) 568 (C. C. A. 2d), certiorari denied, 283 U. S. 837.

While we believed the decision of the court below to be correct, we did not oppose a granting of the writ of certiorari herein for the reason that the court below had recognized (R. 36) that its decision was not consistent with the "broad holding" of *Miller* v. *Commissioner*, 80 F. (2d) 219 (C. C. A. 2d), as to the meaning of this Court's opinion in *Helvering* v. *Rankin*, 295 U. S. 123—and, further, we did not oppose it, although we felt that the *Miller* case might be distinguished from the present case, on the ground hereinafter stated.

In *Helvering* v. *Rankin*, *supra*, this Court held that where the taxpayer has been trading in stocks on a marginal account and identification by certificates is impossible, certificate identification is not the only means of identification, and the taxpayer may resort to identification by dates or cost of purchases in a communication or selling instruction to the broker so as to avoid the application of the first-in first-out rule. There is no question

here of the application of that rule which is applicable only where stock which can not be identified is sold from stock which had been acquired on various dates and at various prices. Here, the stock sold by the taxpayer has been identified.

In *Miller* v. *Commissioner, supra,* the taxpayer directed the broker to sell certain shares purchased on certain dates and then in the broker's possession, but in consummating the sale the broker delivered certificates representing other shares. The court there concluded (p. 221):

> * * * that a designation by instructions to the broker of the shares to be sold is controlling though the certificate delivered does not correspond with the instructions; * * *

This holding that instructions to the broker should prevail over identification by certificates represents, we think, a misconception of the *Rankin* case We submit that the *Rankin* case means only that in the absence of certificate identification, identification by designation of dates or cost of purchases to the broker will suffice, or, stated differently, that in the absence of a better (certificate) identification, the designation by dates of purchase will be sufficient. This Court's opinion in the *Rankin* case means, we submit, as the court below thought (R. 36), that certificate identification is the ordinary and the best means of identification of shares sold, but where, such as by reason of the nature of the dealings in a marginal account,

identification by certificates is not possible, then, identification by designation of dates in a communication to the broker will suffice.

But, even if the *Miller* case correctly interprets the *Rankin* decision, the decision below can be sustained upon a distinction existing in the facts. In the *Miller* case the shares were already in the possession of the broker when the instructions to sell were given, and thus nothing further remained to be done by the seller, whereas in the present case the shares were in the possession of the taxpayer's agent, the bank, so that they were in the possession of the taxpayer as between him and the broker, and the sale was to be consummated by their delivery to the broker—and so they remained subject to the taxpayer's control. This distinction, which the court below recognized (R. 36–37) and which the Board held to be controlling (R. 19), is suggested even by the *Miller* case, where the court, in speaking of some of the cases hereinbefore referred to, said (p. 221):

> But in each of these cases the taxpayer himself had custody of the certificates * * *.

The same distinction applies to *Milliken* v. *Commissioner*, 83 F. (2d) 213 (C. C. A. 2d), where the certificates were likewise in the possession of the broker.

3. After the decision in the *Miller* case, the question of whether taxable gain should be determined upon the basis of the cost of the shares which were actually sold, as represented by the certificates de-

livered, rather than upon the basis of the cost of the shares which the taxpayer intended to sell, was considered in *Vawter* v. *Commissioner, supra,* and *Curtis* v. *Commissioner, supra.* In the *Vawter* case the intention to sell certain specified shares was admitted, and that intention was corroborated by certain entries made by the taxpayer on his records, but certificates representing other shares were delivered by the taxpayer in consummation of the sale. In the *Curtis* case the taxpayer claimed that he intended to sell certain shares which he had acquired on a certain date, but in consummating the sale he delivered certificates representing other shares, and retained those which he intended to sell, or, rather, allowed those which he intended to sell to remain in the possession of a third party as collateral. In both cases the holding of the *Miller* case was relied upon in urging that the taxpayer's intention to sell certain specified shares should prevail over the certificates as the means of identification of the shares sold. Both cases held that gains should be determined upon the basis of the shares represented by the certificates delivered in consummating the sale.

While both of those decisions thus are in keeping with the decision below, they did not involve the precise question presented here, because they did not involve any communication to the broker. They are also distinguishable from the present case in the fact that here the delivery of other certificates in the consummation of the sale came about

by reason of the mistake of the bank. In this respect they are like the companion case of *Edith L. Davidson* v. *Commissioner*, 94 F. (2d) 303 (C. C. A. 8th), certiorari denied May 16, 1938, where the substitution of other certificates in consummating the sale came about solely because of the taxpayer's own act—and not because of the failure of the broker (as in the *Miller* case) or the mistake of the bank (as here). But we submit that in the final analysis this distinction should have no controlling effect because the bank was the custodian of the shares for the taxpayer and should (at least for the purposes of the present controversy) be regarded as the agent of the taxpayer, as suggested in both opinions below (R. 20, 37). The result should be no different than if a private secretary or other employee of the taxpayer had been holding the shares for the taxpayer and had, upon being instructed to make the delivery, delivered the wrong certificates. Clearly, the mistake of the secretary would be regarded as the taxpayer's own mistake, and we submit the mistake of the bank must be treated, for the purposes of the present controversy, as the mistake of the taxpayer.

None of the other cases passes upon the precise question presented. *Snyder* v. *Commissioner*, 295 U. S. 134, dealt, like the *Rankin* case, with a situation where identification by certificates was impossible. *Fuller* v. *Commissioner*, 81 F. (2d) 176 (C. C. A. 1st), and *Kraus* v. *Commissioner*, 88 F. (2d) 616 (C. C. A. 2d), also presented a situation

where identification by certificate was impossible, because the shares held by the taxpayer had been exchanged for new shares of stock in a non-taxable exchange. *Howbert* v. *Penrose,* 38 F. (2d) 577 (C. C. A. 10th), is distinguishable from the instant case because there it was found *as a fact* that the shares the taxpayer intended to sell were actually sold, as the appellate court pointed out (p. 578):

> The trial court found as a fact from the evidence, that "plaintiff intended to *and did sell*" the shares acquired in 1916 and 1917. [Italics supplied.]

4. It is submitted, in conclusion, that the decision of the court below is not only logical but also practical. Where certificate identification is possible, it should be controlling as the means of identification. On the other hand, the adoption of the rule contended for by the taxpayer would result in confusion, for when the taxpayer comes to sell certificates representing the shares bought on March 27, 1929 (which he intended to sell but did not sell in the transaction here involved), the problem then arises as to which shares he will then be selling. Moreover, to adopt the contention of the taxpayer would open the door to fraud, as the court below recognized (R. 37), by making possible collusion between the broker and the taxpayer—a result to be, if reasonably possible, avoided in taxation. And finally, it may be added that, of course, no arbitrary deprivation of the right of the seller to select the shares he desires to sell (*Rankin* opinion,

p. 129–130) results from a rule which merely requires the taxpayer to identify by the best possible means the shares he sells.

CONCLUSION

The decision below is correct and should be affirmed.

Respectfully submitted.

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OCTOBER 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1938

SUPREME COURT OF THE UNITED STATES.

No. 18.—October Term, 1938.

James E. Davidson, Petitioner,
vs.
Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[November 7, 1938.]

Mr. Justice Butler delivered the opinion of the Court.

Upon petitioner's insistence and respondent's admission, that the decision below conflicts with that of the circuit court of appeals for the second circuit in *Miller* v. *Commissioner*, 80 F. (2d) 219, we granted a writ of certiorari. — U. S. —. The question presented is whether petitioner's taxable gain from sale in 1929 of 1,000 shares of stock is to be determined upon the basis of the cost of stock petitioner bought in that year, or upon the basis of lower cost of like shares earlier bought by him.

The details found by the board of tax appeals may be given briefly. March 27, 1929 at cost of $49.90 each, petitioner bought 1,000 shares for which he received 10 separately numbered certificates covering 100 shares each and delivered them to a bank to be held as security for a loan. Some years earlier he had bought, at cost of $4.42 each, 1,000 shares of like stock for which he obtained certificates that he delivered to the same bank as collateral security, where they were held until the sales here involved. June 19, 1929 petitioner instructed his broker to sell 500 shares of the stock he bought March 27, and, to enable the broker to deliver, petitioner instructed the bank to give the broker certificates covering shares bought in that year. By mistake the bank delivered him certificates of shares included in the lot earlier purchased by petitioner. July 1, 1929 petitioner instructed the broker to sell the rest of the lot bought in that year and directed the bank to deliver the broker certificates of the stock petitioner intended to have sold. Again failing to follow instructions, the bank delivered the broker certificates of stock in the other lot. It may be taken as granted that,

when he made his return, petitioner excusably assumed that the bank had followed his directions.

He reported gain on the basis of cost of the stock purchased in that year. The commissioner calculated gain on the basis of cost of the stock earlier purchased and gave notice of deficiency. The board of tax appeals sustained his determination. 35 B. T. A. 555. The circuit court of appeals affirmed. 94 F. (2d) 300.

Petitioner contends that by his reference to amounts and dates of purchases, he adequately designated to the broker the shares to be sold; that in fact the shares so identified were sold and that the bank's delivery of certificates of other stock to the broker did not affect petitioner's order. Undoubtedly, petitioner sufficiently indicated to the broker and to the bank the shares he intended to sell. He plainly allocated the lots to be sold to the 1,000 shares he bought in 1929. But it does not follow that they were the shares sold. His intention to sell, even when coupled with his order to the broker and direction to the bank, cannot be held to constitute sale. *Snyder* v. *Commissioner*, 295 U. S. 134, 137. Notwithstanding his order to the broker to sell shares in the 1929 lot, petitioner was free later to direct that shares from the other lot be used for final consummation of the sale. And so, when the bank delivered him certificates of stock not designated in his order to sell, the broker may well have assumed that petitioner's final purpose was to sell the shares covered by the certificates that the bank sent him. He had no reason to suppose that the bank did not act in accordance with instructions given it by petitioner. The case is not different from what it would have been, if petitioner himself had delivered to the broker the certificates sent by the bank. Plainly, petitioner's contention that the certificates used to complete the sale did not cover the shares sold cannot be upheld. *Commissioner* v. *Rankin*, 295 U. S. 123, 128. The commissioner rightly computed gain on the basis of what was done rather than on what petitioner intended to do. *United States* v. *Phellis*, 257 U. S. 156, 172; *Bonham* v. *Commissioner*, 89 F. (2d) 725, 728; *Curtis* v. *Commissioner*, 89 F. (2d) 736, 738; *Remington Rand, Inc.* v. *Commissioner*, 33 F. (2d) 77, 78.

Affirmed.